

# *Oversight*

# *Report*



QUALITY CONTROL REVIEW OF COOPERS & LYBRAND L.L.P.  
AND THE DEFENSE CONTRACT AUDIT AGENCY  
THE RAND CORPORATION  
FISCAL YEAR ENDED SEPTEMBER 24, 1995

Report Number PO 98-6-006

February 17, 1998

Office of the Inspector General  
Department of Defense

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**ACRONYM**

DCAA Defense Contract Audit Agency  
GAO General Accounting Office  
GAS Government Auditing Standards  
GAAS Generally Accepted Auditing Standards  
OMB Office of Management and Budget

February 17, 1998

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SUBJECT: Quality Control Review of Coopers & Lybrand L.L.P.  
and the Defense Contract Audit Agency  
The RAND Corporation  
Fiscal Year Ended September 24, 1995  
Report No. PO98-6-006

## Introduction

We are providing this report for your information and use. The Los Angeles, California, office of Coopers & Lybrand L.L.P. (Coopers), in coordination with the West Covina, California, office of the Defense Contract Audit Agency (DCAA), performed the single audit for the RAND Corporation (RAND), Santa Monica, California, a nonprofit organization. The audit is required by Office of Management and Budget (OMB) Circular A-133, "Audits of Institutions of Higher Education and Other Nonprofit Institutions." For the fiscal year ended September 24, 1995, Coopers reported total Federal expenditures of \$94,311,394, representing \$65,371,453 for the Department of Defense (DoD) and \$28,939,941 for other Federal agencies.

The Coopers audit report is dated November 3, 1995. The auditors issued an unqualified opinion on the financial statements, Schedule of Federal Awards, and individual reports on internal controls, and compliance requirements. The DCAA issued its incurred cost audit report on July 24, 1997. The DCAA questioned \$355,070 of overhead costs related to Federal research and development programs. The DCAA issued a qualified opinion for FY 1995 incurred costs, because RAND corporation had not provided documentation supporting its compliance with the memorandum of agreement on salary limitation.

Coopers issued positive and negative assurance statements on compliance with general requirements. Positive assurance states that, with respect to the items tested, the results of the auditors' procedures disclosed no material instances of noncompliance. Negative assurance states that, with respect to the items not tested, nothing came to the auditors' attention that caused them to believe that BAND had not complied in all material respects.

Coopers also obtained an understanding of the internal controls related to the financial statements and Federal awards. The audit report describes the auditors' scope of work in obtaining that understanding and in assessing control risk. The report on internal controls further describes the significant internal controls and control structure, including the controls that provide reasonable assurance that Federal awards are being managed in accordance with applicable laws and regulations.

### **Quality Control Review Results**

The coordinated audit performed by Coopers and DCAA, meets the applicable guidance and regulatory requirements in the OMB Circular A-133 and its related Compliance Supplement, which incorporate the Government Auditing Standards (GAS) and generally accepted auditing standards (GAAS).

### **Quality Control Review Objective**

The objective of a quality control review is to ensure that the audit was conducted in accordance with applicable standards and meets the auditing requirements of OMB Circular A- 133. As the Federal oversight agency for RAND, we conducted a quality control review of the Coopers and DCAA audit working papers. We focused our review on the following qualitative aspects of the audit: due professional care, planning, supervision, independence, quality control, internal controls, substantive testing, general and specific compliance testing, and the Schedule of Federal Awards.

We reviewed the most recent peer review letter for Coopers, issued by Ernst & Young L.L.P., on September 23, 1994. The peer review found that Coopers met the objectives of the quality control review standards established by the American Institute of Certified Public Accountants and that Coopers complied with the standards during the fiscal year ended March 31, 1994. However, the peer review letter contained recommendations for improvements in the area of supervision.

## **Scope and Methodology**

We used the 1991 edition of the Uniform Quality Control Guide for Single Audits (the Guide) that was approved by the President's Council on Integrity and Efficiency as guidance for performing the quality control review procedures. The Guide is organized by the general and field work audit standards and the required elements of a single audit. The Guide is further divided into the substantive audit work performed during the audit of the financial statements and the specific program compliance testing for major programs. In addition, we supplemented the Guide to include additional review of transaction testing. Our review was conducted from September 29 through October 3, 1997.

We limited the scope of our quality control review to the audit working papers covering areas related to the financial statements and the research and development program. The research and development program expenditures totaled about \$94 million and accounted for 100 percent of total Federal award expenditures at RAND.

## **Results of Prior Quality Control Reviews**

We identified minor quality control review findings and made recommendations at 3 of the 11 Coopers locations we visited from January 1, 1995, through September 15, 1997. The affected offices were notified, and no further action is necessary.

## **Background**

The Inspector General Act of 1978, Public Law 95-452, prescribes the duties and responsibilities of that office. In implementing those responsibilities, the Inspector General is required to "take appropriate steps to assure that any work performed by non-Federal auditors complies with the standards established by the Comptroller General."

The Single Audit Act of 1984 (Public Law 98-502) was intended to improve the financial management of state and local governments whose total annual expenditures are \$100,000 or more with respect to Federal financial assistance programs; establish uniform requirements for audits of Federal financial assistance; promote efficient and effective use of audit resources; and ensure that Federal departments and agencies rely on and use the audit work done under the Act, to the maximum extent practicable.

The Single Audit Act Amendments of 1996, based on 12 years of experience under the 1984 Act, are intended to strengthen the usefulness of single audits by increasing the audit threshold from \$100,000 to \$300,000 in Federal financial assistance before an audit is required under the Act; by selecting programs to be audited on the basis of risk assessment rather than the amount of funds involved; and by improving the contents

and timeliness of single audits. The Amendments also bring nonprofit organizations, previously covered by similar requirements in the OMB Circular A-133, under the Single Audit Act.

The OMB Circular A-133 establishes the Federal audit and reporting requirements for nonprofit and educational institutions whose Federal awards are or exceed \$100,000. The Circular provides that an audit made in accordance with the Circular shall be in lieu of any financial audit required under individual Federal awards. An agency must rely on the audit to the extent that it provides the information and assurances that an agency needs to perform its overall responsibilities. The coordinated audit approach provides for the independent public accountant, Federal auditor, and other non-Federal auditors to consider each other's work in determining the nature, timing, and extent of their respective audit procedures. The Circular also requires that the cognizant agency obtain or conduct quality control reviews of selected audits made by non-Federal auditors and provide the results, when appropriate, to other interested organizations. The revised Circular was issued on June 24, 1997, to incorporate the changes in the Single Audit Act Amendments of 1996. Its provisions apply to audits of fiscal years beginning after June 30, 1996.

## **Discussion of Results**

During our quality control review, we reviewed and took no exception to the working papers supporting the following reports.

**Report of Independent Accountants.** The auditor is required to obtain reasonable assurance about whether the financial statements are free of material misstatement. We reviewed the audit program and the testing of evidential matter to determine whether testing was sufficient, based on assessment of control risk, to warrant the conclusion reached and whether the working papers supported the conclusion.

**Report of Independent Accountants on Internal Control Structure Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards.** The auditor is required to obtain an understanding of the internal control structure that is sufficient to plan the audit and to assess control risk for the assertions embodied in the financial statements. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the substantive testing performed.

**Report of Independent Accountants on Compliance with Laws, Regulations, Contracts, and Grants Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards.** The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on the determination of financial statement amounts. We

reviewed the audit program for the appropriate procedures, the working paper documentation, its support, and the compliance tests performed.

**Report of Independent Accountants on Schedule of Federal Awards.** The auditor is required to subject the schedule to the auditing procedures applicable to the audit of the financial statements and to ensure that the amounts are fairly stated in relation to the basic financial statements. Our review was included in the steps of evaluation of the audit working papers related to the Report of Independent Accountants.

**Report of Independent Accountants on Internal Control Structure Used in Administering Federal Awards.** The auditor is required to obtain an understanding of the internal control structure to assess control risk to determine whether the auditor intends to place reliance on the internal control structure. The auditor must perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance, to review the system for monitoring subrecipients and obtaining and acting on subrecipient audit reports, and to determine whether controls are effective to ensure that direct and indirect costs are calculated and billed in accordance with the general requirements in the Compliance Supplement. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the test of controls performed.

**Report of Independent Accountants on Compliance With General Requirements.** The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. General requirements are those that could have a material effect on the recipient's financial statements including those prepared for Federal programs. The auditors' procedures were limited to those prescribed in the OMB Circular A-133 Compliance Supplement. We reviewed the audit program for the appropriate procedures, compared the audit program steps to those in the Compliance Supplement to make sure that all areas were audited, reviewed the working paper documentation and its support, reviewed the compliance tests performed, and reevaluated selected compliance items.

**Report of Independent Accountants on Compliance With Specific Requirements Applicable to Major Programs.** The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on its major Federal programs, including Types of Services Allowed or Unallowed; Eligibility; Matching, Level of Effort, and/or Earmarking Requirements; Special Reporting Requirements; and Special Tests and Provisions. We reviewed the audit program for the appropriate procedures, checked the audit program steps to those in the Compliance Supplement to make sure all areas were audited, reviewed the working paper documentation and its support, reviewed the compliance tests performed, and reevaluated selected compliance items.

**Schedule of Findings and Questioned Costs** The auditor is not required to but may report immaterial findings in the audit report or report them to the recipient in a separate written communication. The recipient is responsible for forwarding the findings to the Federal grantor agencies. We traced the findings in the working papers to the audit report to make sure that the report includes all findings identified in the working papers and that the findings are properly supported. We noted one repeat audit finding that had not been resolved from the prior year's audit. A complete list of all audit findings is in Enclosure 1.

## Comments

Because this report contains no findings or recommendations, written comments are not required. We appreciate the courtesies extended during our review. If you have questions on this report, please contact Ms. Barbara Smolenyak, Program Director, at (703) 604-8761. The report distribution is in Enclosure 2.



Robert J. Lieberman  
Assistant Inspector General  
for Auditing

Enclosures



**The RAND Corporation**  
**Schedule of Findings and Questioned Costs for**  
**Fiscal Year Ended September 24, 1995**

**Coopers and Lybrand L.L.P.**

<u>Audit Report</u> <u>Page No.</u>	<u>Description</u>	<u>Questioned</u> <u>costs</u>	<u>Resolution</u> <u>Agency</u>
18	Noncompliance With Financial Reporting Requirements	NA*	DoD

**Defense Contract Audit Agency**

<u>Audit Report</u> <u>Page No.</u>	<u>Description</u>	<u>Questioned</u> <u>costs</u>	<u>Resolution</u> <u>Agency</u>
6-7	Outside Services (Legal Expenses)	\$ 70,583	DoD
6-9	Miscellaneous: Interunit Expenses	\$254,871	DoD
	Fellowships	\$ 29,616	DoD

\* Not Applicable

Enclosure 1

**The RAND Corporation**  
**Fiscal Year Ended September 24, 1995**

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